



Attachment 1

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Managing Director & Principal*

September 2, 2008

Ms. Anne Stausboll
Interim Chief Investment Officer
California Public Employees' Retirement System
400 P Street, Suite 3492
Sacramento, CA 95814

Re: International Fixed Income Manager Contract Renewal Recommendation¹

Dear Anne,

You requested Wilshire's opinion with respect to Staff's recommendation pertaining to the annual review and renewal of the contracts of the international fixed income managers. Wilshire concurs with Staff's recommendations, and our comments regarding all seven managers are below.

Discussion

During the 2008 fiscal year, the CalPERS International Fixed Income manager program outperformed its benchmark by 0.14%, reversing a 0.15% underperformance in the last review period for fiscal 2007. Since inception, the international fixed income program has added an average of 0.81% of outperformance per year, and 0.08% per year since September 2000, but due to a significant restructuring of this program, prior period performance is not directly comparable to the portfolio of managers as it exists today. We believe that the longer term results are difficult to compare to the current program for three reasons: First, three of the five current managers were added in 2007, with a fourth manager added in 2007, who then resigned in 2008. Second, two long-term managers resigned from this portfolio a couple of years ago. Third, in the spring of 2007 the managers were granted increased leverage and shorting freedom that changed some elements of the risk and return potential in the portfolio. As a result, although we believe that the long-term positive results from this portfolio are important, we believe that this portfolio should be evaluated going forward from the date of the last of these major changes.

¹ Wilshire's Code of Conduct requires us to disclose which of the above firms are clients of Wilshire's Analytics Services Division and as such pay Wilshire a fee for the licensing of analytical software used in investment management. Wilshire's consulting division has no business relationship with them. This disclosure has been delivered under separate cover and is included as an attachment to this agenda item.

We note that both of the longer term (legacy) managers dramatically outperformed during the review period, reversing underperformance by both managers in the prior year – illustrating that patience with managers can reward investors. One of the newer three managers also added value in fiscal 2008, although the other two underperformed. Given the recent volatility in the asset class (benchmark returns were a staggering 17.49% for the year), in our opinion the Investment Committee should be pleased with a program that outperformed overall for the year and renew all five managers' contracts for another year. The Spring-Fed Pool structure allows Staff the ability to terminate or replace managers at any time, and the renewal of these contracts does not necessarily require all managers to be retained for an additional year.

AllianceBernstein

Alliance was one of the new managers hired under the RFP last year, and was first funded in February 2007. The manager added 0.49% of value in the first fiscal year, but underperformed by 98bp in fiscal 2008. Alliance relies heavily on fundamental credit research and has suffered during the “credit crunch” and continued deterioration of much of the corporate credit market. If the economy and credit sector recover in 2009, we would expect this manager's performance to recover as well.

Baring Asset Management

Baring is one of the “legacy” managers, and was first funded in October 1989. Since inception, the manager has added 1.31% of annualized outperformance and outperformed by 1.11% in fiscal 2008. Baring's investment process provides significant strategy diversification in the portfolio, as the manager bases most of its investment decisions not on bottom-up issue selection, but rather on macro-economic projects of currency, country, and rate movements. The success or failure of this investment process should be uncorrelated with some of the newer managers, who rely much more heavily on sector and issue selection.

Mondrian

Mondrian has outperformed since its inception date of March 2007 by 1.98%. The manager employs a defensive, value, and quantitative investment style that should outperform over the long term, but may underperform when its style is out of favor. In addition, the manager relies on a Purchasing Power Parity construct to determine proper currency valuation, and this methodology tends to work over very long-term periods but can drastically underperform over the short run. When these models become successful again, we expect this manager to add value. Since inception, the manager's investment style has worked as expected, underperforming in the stronger fiscal 2007 year but adding 3.30% in fiscal 2008 when managers with a defensive style outperformed those who relied on the credit or mortgage sectors for returns.

Pacific Investment Management Company (PIMCO)

PIMCO has managed assets for CalPERS since April 2007, and has underperformed by 0.84% since inception. PIMCO uses a combination of some of the same macro factors discussed above (i.e., economic growth, inflation outlook, currency valuations) and traditional security and sector selection, although the firm has tended to lean more heavily on its macroeconomic forecasts over time. PIMCO's underperformance in 2007 resulted from a prediction that central banks, especially in the US, would begin to cut interest rates rapidly in response to the looming sub-prime collapse, which had not yet come to pass as of the end of June 2007. Although PIMCO performed well in many of its portfolios in the second half of calendar 2007 following the beginning of the "credit crunch" in July and August, PIMCO began to shift out of government securities and into corporate bonds by early calendar 2008. This position is "betting" on a strong economic recovery which has not yet come to pass. As a result, PIMCO underperformed by 56bp for fiscal 2008.

Rogge Global Partners

Rogge was funded at the time of the last program restructuring, in September 2000. The manager outperformed by 2.45% over the past fiscal year and added an average of 0.42% per year since inception. This manager's process is based on a macroeconomic study of each country's major economic factors that determine interest rates (i.e., debt, growth, etc.) The manager then takes fairly concentrated positions in the countries with the highest expected future value. Individual issue selection takes a back seat to country and currency decisions in this investment process.

Conclusion

Through the on-going activities of both CalPERS' consulting team and Wilshire's Manager Research Group, we closely monitor the performance and investment processes of all of CalPERS' managers. At this time, Wilshire concurs with Staff's recommendation to renew the contracts for all of the international fixed income managers, as CalPERS still has the right to terminate any of these managers with 30 days notice.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael A. ...", is written over a horizontal line.